Cork Exploration Inc.

ANNUAL REPORT
FOR THE PERIOD ENDED DECEMBER 31, 2005

MANAGEMENT'S DISCUSSION AND ANALYSIS

March 28, 2006

This management's discussion and analysis of the financial condition and results of operations of Cork Exploration Inc. should be read in conjunction with the accompanying audited financial statements and the notes thereto for the period from incorporation on February 14, 2005 to December 31, 2005.

The following is a discussion of management's analysis of the operating and financial activities of Cork from inception to December 31, 2005, as well as certain estimates of future operating and financial performance based on information currently available. Funds from operations and operating netback as used in this discussion and analysis by management are not defined under generally accepted accounting principles. Management uses funds from operations as an alternate measure to analyze operating performance. The reconciliation between net income and funds from operations can be found in the statement of cash flows in the audited financial statements. Funds from operations per share is calculated using the weighted average shares outstanding consistent with the calculation of income per share. Operating netback measures the amount of revenues received after royalties and operating costs and is a useful supplemental measure of performance commonly used in the oil and gas industry. However; readers are cautioned that the Corporation's method of calculating operating netback may differ from other companies.

Certain disclosure may be presented on a per barrel of oil equivalent (boe) basis. Boes may be misleading, particularly if used in isolation. A boe conversion ratio of 6 mcf to 1 bbl is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.

Forward-Looking Statements

Certain information contained throughout this annual report, including management's current assessment of the Corporation's future plans and operations are not historical facts and may be considered forward-looking statements. By their very nature, such statements involve inherent risks and uncertainties, many of which are beyond the Corporation's control.

Actual results could differ materially from those currently anticipated due to any number of factors, including such variables as new information regarding recoverable reserves, competition from other producers, operational risk in exploring for, developing and producing crude oil and natural gas, changes in commodity prices, legislative, environmental and other regulatory and political changes and other factors discussed in this annual report. Accordingly, no assurance can be given that any events anticipated by the forward-looking statements will occur and what the actual effect on Cork Exploration Inc. will be.

Forward-looking statements are based on the estimates and opinions of the Corporation's management at the time the statements are made. The Corporation assumes no obligation to update forward-looking statements should circumstances or management's estimates or opinions change.

Comparability of Prior Period Results

The Corporation was incorporated on February 14, 2005 and completed its private placement on May 5, 2005. As such, there are no prior year results available for comparison.

2005 Highlights

- Cork experienced excellent drilling results and successfully drilled and cased 7 wells (3.30 net wells) and re-entered an additional well (0.67 net wells) establishing a 100% success rate for 2005.
- The Corporation completed a private placement of 34,500,000 common shares at a price of $1.00 per share for gross proceeds of $34,500,000 of which 1,455,000 shares were issued as flow-through common shares.
- Cork is in a strong balance sheet position with a working capital balance of $16,938,000 as of December 31, 2005.

Growth in Value – Cork's Strategy

The management team of Cork believes that growth through the drill bit will lead to the highest rate of return on shareholder investment. To reduce the risks inherent in the oil and gas industry, management will focus its activities

towards drilling deep basin trapped gas reserves west of the fifth meridian. Our business strategy is to concentrate our efforts on company generated and operated, high working interest prospects in West Central Alberta where management's experience has helped to create high rates of returns in past ventures.

RESULTS OF OPERATIONS

Production revenues and operating costs

The Corporation acquired a 10% working interest in a producing oil and gas well prior to the private placement on May 5, 2005. The Ewing Lake well produced 1 barrel (bbl) per day at an average price of $65.57 per bbl until its sale on December 1, 2005. Freehold royalties at 15% and operating costs averaging $7.47 per bbl resulted in a netback per bbl of $48.59 for the seven months during which Cork had an interest in the well.

Production of gas from a Pembina well in which Cork owns a 66.67% interest commenced on December 1, 2005 and a Brazeau well owned 33.34% commenced production on December 24, 2005.

Production	**Three months ended December 31, 2005**			**From inception to December 31, 2005**		
	Gas (mcf)	Oil & Ngls (bbl)	(boe)	Gas (mcf)	Oil & Ngls (bbl)	(boe)
Pembina	35,550	1,420	7,345	35,550	1,420	7,345
Brazeau	2,314	72	458	2,314	72	458
Ewing Lake	-	60	60	-	242	242
Total production	37,864	1,552	7,863	37,864	1,735	8,045

Revenues

Revenue during the three months ended December 31, 2005 increased due to the commencement of production from one well at Pembina and one well at Brazeau in December.

Petroleum and natural gas sales	**Three months ended December 31, 2005**	**From inception to December 31, 2005**
Natural gas sales	$ 512,440	$512,440
Crude oil and ngls	104,070	115,311
Total petroleum and natural gas sales	$616,510	$627,751

Marketing

Cork markets its oil, natural gas and liquids in the Alberta spot markets at various delivery points.

Royalties

Cork's royalty rate averaged 25.3% before ARTC for the last three months of 2005 as compared to 14.5% for the period ended September 30, 2005 due to the commencement of gas and ngl sales from the Brazeau and Pembina wells. Previously, Cork's only royalty obligation was a 15% freehold royalty on the Ewing Lake well.

	Three months ended December 31, 2005	From inception to December 31, 2005
Crown	$155,347	$155,347
Freehold	612	2,302
ARTC	(38,837)	(38,837)
Net royalties	$117,122	$118,812
Net royalties per boe	$ 14.90	$ 14.77

Interest Income

Cork invested its cash in various term deposits and guaranteed investment certificates with several large Canadian banks at rates ranging from 2.75% to 3.44% during the three months ended December 31, 2005 to earn total interest of $213,850 during the quarter. Total interest earned from inception to December 31, 2005 was $516,633.

Operating expenses

Operating expenses, on a per barrel of oil equivalent basis increased slightly during the last three months of 2005 due to the production of gas and ngls from the two new wells at Pembina and Brazeau.

	Three months ended December 31, 2005	From inception to December 31, 2005
Transportation	$11,519	$11,519
Other	37,611	39,031
Total operating expenses	$49,130	$50,550
Operating expenses per boe	$ 6.25	$ 6.28

Operating Netback

High oil and gas prices and low operating costs have resulted in a strong netback for Cork during 2005.

Netback per boe	Three months ended December 31, 2005	From inception to December 31, 2005
Average sales price	$78.41	$78.03
Royalties	(14.90)	(14.77)
Operating expenses	(6.25)	(6.28)
Operating netback per boe	$57.26	$56.98

Depletion, depreciation and accretion

Depletion, depreciation and accretion (DD&A) increased to $102,332 during the last three months of 2005 from $5,407 expensed to September 30, 2005 due to higher production levels and increased capital expenditures.

	Three months ended December 31, 2005	From inception to December 31, 2005
Petroleum and natural gas properties	$99,083	$99,457
Office furniture and fixtures	3,249	8,147
Accretion of asset retirement obligation	-	135
DD&A expense	$102,332	$107,739
DD&A per boe	$ 13.01	$ 13.39

General and Administration

Direct costs and consulting fees associated with the exploration department have been capitalized, a policy consistent with generally accepted accounting policies.

	Three months ended December 31, 2005	From inception to December 31, 2005
Gross general and administration	$ 438,761	$1,014,044
Capitalized geological costs	(271,875)	(597,251)
Overhead recoveries	(170,652)	(186,877)
Net general and administration	$ (3,766)	$ 229,916
Net general and administration expenses per boe	$ (0.48)	$ 28.58

Cork's gross general and administrative costs will increase further in 2006 as a result of expanded office space and additional personnel as needed to accommodate the Corporation's growth. On a per boe basis, however; general and administrative expenses should decrease significantly as production from new wells commences in the first quarter of 2006.

On March 15, 2006, the Board of Directors of the Corporation approved the immediate payment of bonuses to its employees totalling $137,000 which will be expensed in the first quarter of 2006. An additional $213,000 has been approved for payment later in 2006 pending certain performance hurdles.

Stock-Based Compensation Expense

The Corporation has issued stock options and performance warrants to directors, officers, employees and consultants. Compensation costs attributable to the stock options and performance warrants granted are accounted for in accordance with the fair value method of accounting at the date of the grants and expensed or capitalized over the vesting period with an offsetting amount recorded to contributed surplus. The estimates of the fair values are determined using the Black-Scholes options pricing model. When stock options or performance warrants are exercised, the cash proceeds together with the amount previously recorded as contributed surplus will be recorded as share capital. The Corporation does not incorporate an estimated forfeiture rate for stock options or performance warrants that will not vest, but accounts for forfeitures as they occur.

In calculating the fair value of the options granted in 2005, the assumptions made include, a weighted average risk-free interest rate of 3.46%, no dividend yield, a weighted average expected life of options of 3 years and a vesting period of

two years. The fair value of the 2005 common share options was estimated to be $153,000 of which $13,222 is included as a stock-based compensation expense and $54,778 is capitalized for the period ended December 31, 2005. In 2006, $12,750 of stock-based compensation will be recognized in each of the four quarters related to the granting of options in 2005.

In calculating the fair value of the performance warrants granted in 2005, the assumptions made include, a weighted average risk-free interest rate of 3.64%, no dividend yield, a weighted average expected life of the warrants of 3 years. The performance warrants became fully vested by December 31, 2005. The fair value of the 2005 warrants was estimated to be $2,346,000, of which $751,000 is included as a stock-based compensation expense and $1,595,000 is capitalized for the period ended December 31, 2005.

During the year, the Company issued flow through shares to management at an estimated value of $1.00 per flow through share. As no premium was assigned to these shares, the Company recorded additional stock based compensation of $291,000 in 2005. Compensation costs attributable to the benefit of flow-through shares issued to management were measured at the estimated fair value of the flow through shares based upon historical premiums ascribed to flow-through shares of similar corporations less the issue price of the flow-through share.

Net Loss

Due to 2005 being the first period of operations for Cork, production from internally generated discoveries not commencing until December, and a large stock option benefit expense recognized due to the vesting of the performance warrants, the Corporation sustained a loss of $553,893 from the date of inception to December 31, 2005 ($239,344 for the three months ended December 31, 2005).

Funds from Operations

Funds from operations for the fourth quarter of 2005 were $667,874 ($745,106 for the period from the date of incorporation to December 31, 2005).

	Three months ended December 31, 2005	From inception to December 31, 2005
Funds from operations	$667,874	$745,106
Funds from operations per boe	$ 84.94	$ 92.62
Funds from operations per share (basic and diluted)	$ 0.02	$ 0.02

Cash and cash equivalents, consisting of term deposits and guaranteed investment certificates, as of December 31, 2005 were $17,938,193.

Future Income Taxes

The Corporation has recorded future income tax recoveries of $386,611 as at December 31, 2005. This asset will reverse in the first quarter of 2006 with the renunciation of flow-through shares which occurred in February, 2006 for expenditures incurred in 2005. Tax pools are available to reduce future taxable income at December 31, 2005, (after giving effect to the flow-through renunciations) as follows:

	Deduction Rate	**2005**
Canadian exploration expense	100%	$ 6,257,000
Canadian development expense	30%	828,000
Canadian oil & gas property expense	10%	4,640,000
Capital cost allowance	20-30%	1,618,000
Share issue costs	20%	1,552,000
Non-capital loss carry forward (available to 2015)	100%	1,045,000
Alberta attributed royalty income deduction		161,000
Total		$16,101,000

Capital Expenditures

The Corporation participated as to its share in the drilling of 7 wells (3.30 net wells) and the re-entry of a well (0.67 net wells) during the period from incorporation to December 31, 2005. Capital expenditures have been incurred as follows:

	Three months ended December 31, 2005	**From inception to December 31, 2005**
Drilling and completions	$6,472,264	$9,048,543
Equipment and facilities	1,399,163	1,818,997
Land and maintenance	4,749,454	5,104,310
Seismic	88,586	395,114
Total capital expenditures	$12,709,467	$16,366,964

Impairment test

The Corporation calculates an impairment test quarterly and annually whereby the carrying value of petroleum and natural gas properties is compared to the estimated future cash flow from the production of proved reserves measured in accordance with the requirements of the Canadian Institute of Chartered Accountants AcG-16 "Oil and Gas Accounting – Full Cost, a two step process. The Corporation calculated the impairment test using the price forecast of Gilbert Laustsen Jung as of December 31, 2005 and no impairment adjustment was required.

Liquidity and Capital Resources

Initial private capital of $34,500,000 was raised in May, 2005 by issuing 34,500,000 common shares at $1.00 per share consisting of 33,056,000 common shares and 1,455,000 flow-through common shares. Directors, officers, employees and key consultants purchased 1,455,000 Common shares and 1,455,000 flow-through Common shares for a total of 8.4% of the issued shares. The Corporation incurred share issuance costs of $1,940,062.

As at December 31, 2005, the Corporation had working capital of $16,938,081. Cork expects to utilize this working capital in the first half of 2006 on land acquisitions, drilling and development related activities. The Board of Directors has approved a 2006 Capital Budget of $50,000,000 and expenditures over and above the current working capital and 2006 operating cash flows will be funded by new equity and/or bank financing. The Corporation is currently negotiating a borrowing facility.

Cork is committed to maintaining a strong balance sheet to minimize exposure to volatile product prices and to maximize its ability to participate in opportunities that arise both internally and from industry partners.

Outstanding Share Data

As of December 31, 2005, the Corporation had the following securities outstanding: 34,500,001 common shares of which 1,455,000 were issued as flow-through common shares; options granted to certain employees, consultants and directors of the Corporation to acquire 450,000 common shares and performance warrants exercisable to acquire 6,900,000 common shares at $1.00 per share.

On March 15, 2006, the Board approved the issuance of additional stock options to certain employees, consultants and directors to acquire 2,030,000 common shares at $1.75 per share.

Off-Balance Sheet Arrangements

The Corporation does not have any special purpose entities nor is it a party to any arrangements that would be excluded from the balance sheet.

Contractual Obligations

The Corporation leases office premises under an agreement, which expires in June, 2010. The minimum lease payments required under the lease are $157,300 for 2006 through 2009 and $78,600 for 2010.

On November 1, 2005, the Corporation entered into an agreement with an industry partner whereby the Corporation committed to drill five wells to earn an interest in ten sections (3840 net acres) of land. Should the Corporation drill and complete or abandon less than five wells prior to July 31, 2006, the Corporation must pay the industry partner a penalty of $1,500,000 for each well not drilled and in addition will not earn an interest in any of the lands. To date, two wells under this agreement have been completed and the third is expected to spud prior to the end of March. The Corporation is committed to drill and complete the last two wells prior to July 31, 2006.

On January 16, 2006, the Corporation entered into an agreement with a certain drilling contractor whereby the Corporation committed to the use of a drilling rig for a minimum of 230 days prior to December 31, 2006 at rates that are consistent with current standard industry rates.

Related Party Transactions

Directors and officers have purchased 2,500,001 common shares, of which 1,275,000 are flow-through common shares. Of the 6,900,000 performance warrants issued by the Corporation, 4,316,260 were issued to officers and directors.

A company controlled by one of the directors of the Corporation provided engineering consulting services during the year in the amount of $23,355.

The Corporation uses the services of a law firm in which one of its partners became a Director in October, 2005. During the period from the date of incorporation to December 31, 2005, the Corporation incurred $106,742 on services provided by the firm. The services related to financing and other general corporate matters.

Business Risks, Environment and Safety

The oil & gas industry is subject to uncertainties and risks including the volatility of commodity prices, changes in market demand for products, exploration success, transportation interruptions, foreign exchange and interest rates, government regulations and taxes, environmental impact and safety concerns.

Cork strives to minimize these risks by proper management of these factors. The Corporation employs a highly qualified staff of professionals, maintains a strong and flexible financial position and maintains proactive environmental and safety operating procedures. Policies are designed internally to successfully deal with the extensive regulations of the oil and gas industry. The Corporation is committed to minimizing the effects of its activities on the environment and protecting its employees. Cork has a formal Emergency Response Plan setting out procedures, which employees and contractors must follow in the event of an operational emergency. The Corporation maintains comprehensive insurance to cover risks of well blowouts and pollution as well as coverage for personnel and directors executing their corporate duties. Cork will focus its efforts on low cost reserve additions and cash flow optimization to lay the foundations for future growth. Extensive geological, geophysical, engineering, environmental and financial analyses are performed on new drilling prospects and potential acquisitions. Concentrating our efforts in areas with multi-zone potential and existing in-

house expertise will minimize exploration risks.

Critical Accounting Estimates

The Corporation's accounting policies are described in Note 2 of the financial statements for the period from incorporation on February 14, 2005 to December 31, 2005. Certain accounting policies are identified as critical because they require management to make judgements and estimates based on conditions and assumptions that are inherently uncertain. These accounting policies could result in materially different results should the underlying assumptions or conditions change. Management assumptions are based on factors that, in management's opinion, are relevant and appropriate, however; such assumptions may change over time as operating conditions change.

Critical Accounting estimates include:

Oil and natural gas reserves

Changes in estimated proved reserves or future development costs can have a significant impact on net earnings as they have a direct impact on depletion and depreciation expense. The Corporation's proved reserves are evaluated by a firm of independent petroleum engineers. Uncertainties regarding projected future rates of production, commodity price forecasts, the timing of future expenditures and the interpretation of engineering data make the evaluation of reserves a subjective process. Revisions to reserve estimates could result in higher depletion and depreciation expense and could also lead to an impairment write-down of property, plant and equipment.

Asset retirement obligations

The fair value of the Corporation's legal obligations associated with the retirement of long term assets is recorded as a liability with a corresponding increase in the carrying amount of the related properties. Determination of the obligations is based on estimates using current costs and technology to abandon and reclaim the wells and facilities and the estimated timing of such costs. A change in these estimates or the discount rate used to calculate the present value of such costs would impact the asset retirement obligations.

Income taxes

The determination of the Corporation's income and other tax liabilities requires interpretation of complex laws and regulations involving multiple jurisdictions. All tax filings are subject to audit and potential reassessment after the lapse of considerable time. Accordingly, the actual income tax liability may differ significantly from that estimated and recorded.

Stock-based compensation

Compensation costs attributable to share options and performance warrants granted are measured at estimated fair value at the grant date and expensed or capitalized over the term of the expected vesting periods. Determination of the estimated fair market value is based on the estimated volatility of the price of the Corporation's common shares, the expected length of time until the exercise dates and the estimated risk-free interest rates.

Other estimates

The accrual method of accounting requires management to incorporate certain estimates such as revenues, royalties and production costs as at a specific reporting date for which actual amounts have not yet been received. Also, estimates on capital projects which are in progress must be made where actual costs have not been received at a specific reporting date.

AUDITORS' REPORT

To the shareholders of Cork Exploration Inc.

We have audited the revised balance sheet of Cork Exploration Inc. as at December 31, 2005 and the revised statements of income and retained earnings and cash flows for the period from inception on February 14, 2005 to December 31, 2005. These revised financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these revised financial statements present fairly, in all material respects, the financial position of the Corporation as at December 31, 2005 and the results of its operations and its cash flows for the period from inception on February 14, 2005 to December 31, 2005 in accordance with Canadian generally accepted accounting principles.

Our previous audit report dated March 22, 2005 has been withdrawn and the consolidated financial statements have been revised to reflect the adjustment for stock based compensation as described in Note 5 to the revised financial statements.

Calgary, Canada
March 22, 2006 (except for Note 5 which is as of June 14, 2006 and Note 10 which is as of June 21, 2006)

(signed) *"Ernst & Young LLP"*
Chartered Accountants

CORK EXPLORATION INC.
Balance Sheet

	December 31, 2005 (restated note 5)
ASSETS	
Current	
Cash and cash equivalents	$ 17,938,193
Accounts receivable (note 8)	6,741,148
Prepaid expenses and deposits	59,278
	24,738,619
Property and equipment (note 3)	18,140,149
Future income tax asset (note 6)	386,611
	$ 43,265,379
LIABILITIES	
Current	
Accounts payable and accrued liabilities	$ 7,800,538
Asset retirement obligations (note 4)	101,546
SHAREHOLDERS' EQUITY	
Share capital (note 5)	33,212,188
Contributed surplus (note 5)	2,705,000
Deficit	(553,893)
	35,363,295
	$ 43,265,379

See accompanying notes to the financial statements

On behalf of the Board,

(signed)

"Philip E. Collins"

Director

(signed)

"Raymond G. Smith"

Director

CORK EXPLORATION INC.
Statement of Loss and Deficit

For the period from inception on February 14, 2005 to December 31, 2005
(restated note 5)

Revenues	
Petroleum and natural gas sales	$ 627,751
Royalties, net of ARTC	(118,812)
Interest	516,633
	1,025,572
Expenses	
Operating	50,550
Depletion and depreciation (note 3)	107,739
General and administration (note 3)	229,916
Stock-based compensation (note 5)	925,622
	1,313,827
Loss before taxes	(288,255)
Taxes	
Future income tax expense (note 6)	(265,638)
Net loss for the period and deficit, end of period	$ (553,893)
Net loss per share (basic and diluted)	$ (0.02)

See accompanying notes to the financial statements

CORK EXPLORATION INC.
Statement of Cash Flows

For the period from inception on February 14, 2005 to December 31, 2005
(restated note 5)

Operating activities	
Net loss for the period	$ (553,893)
Items not affecting cash:	
Future income tax expense	265,638
Stock-based compensation	925,622
Depletion and depreciation	107,739
Funds from operations	745,106
Increase in accounts receivable and deposits	(820,021)
Increase in accounts payables and accrued liabilities	299,542
	224,627
Financing activities	
Issuance of common shares	34,500,001
Issuance costs	(1,940,062)
	32,559,939
Investing activities	
Property and equipment additions	(16,366,964)
Increase in accounts receivable	(5,980,405)
Increase in accounts payable and accrued liabilities	7,500,996
	(14,846,373)
Increase in cash and cash equivalents	17,938,193
Cash and cash equivalents, beginning of period	-
Cash and cash equivalents, end of period	$ 17,938,193

See accompanying notes to the financial statements

CORK EXPLORATION INC.
NOTES TO FINANCIAL STATEMENTS

1. INCORPORATION AND BUSINESS OF THE CORPORATION

The Corporation was incorporated under the laws of the Province of Alberta on February 14, 2005 under the name of 1152311 Alberta Ltd. The business of the Corporation is the exploration for, acquisition, development and production of petroleum and natural gas reserves in the Western Canada Sedimentary Basin. On March 15, 2005, the Corporation changed its name to Cork Exploration Inc.

2. SIGNIFICANT ACCOUNTING POLICIES

The financial statements of the Corporation have been prepared in accordance with Canadian generally accepted accounting principles. Management has made necessary estimates and assumptions regarding certain types of assets, liabilities, revenues and expenses in the preparation of the financial statements. Such estimates primarily relate to unsettled transactions and events as of the date of the financial statements. Accordingly, actual results may differ from estimated amounts but management does not believe such differences will materially affect the Corporation's financial position or results of operations. Significant accounting policies are summarized as follows:

Comparability of Prior Year Results

The Corporation was incorporated on February 14, 2005. As such, there are no prior year results available for comparison.

Cash and cash equivalents

As at December 31, 2005, cash and cash equivalents include short-term deposits of $17,858,459 with maturity dates of three months or less with a weighted average interest rate of 3.4 percent.

Petroleum and natural gas properties

The Corporation follows the full cost method of accounting for oil and gas operations. All exploration, development and acquisition costs for oil and gas properties and related reserves are capitalized into a single Canadian cost centre. Such costs include land acquisition costs, costs of drilling both productive and non-productive wells, and geological and geophysical expenses and certain general and administrative expenditures directly related to exploration.

Gains or losses on the sale or disposition of petroleum and natural gas properties are not recognized unless recognition would result in a change of more than twenty percent in the depletion rate.

Depletion and depreciation

Depletion of petroleum and natural gas properties is provided using the unit-of-production method based on production volumes before royalties in relation to total estimated proved reserves as determined by independent reserve engineers and calculated in accordance with National Instrument 51-101. Natural gas reserves and production are converted at the energy equivalent of six thousand cubic feet to one barrel of oil.

Calculations for depletion and depreciation of production equipment are based on total capitalized costs plus estimated future development costs of proved undeveloped reserves less the estimated net realizable value of production equipment and facilities after the proved reserves are fully produced. The costs of acquiring and evaluating unproved properties are excluded from depletion calculations. These properties are assessed periodically to ascertain whether impairment has occurred. When the property is considered to be impaired, the cost of the property or the amount of the impairment is added to costs subject to depletion.

Ceiling test

The Corporation applies a two-stage ceiling test to capitalized costs on a quarterly basis. The first step determines whether capitalized costs are recoverable by ensuring such costs do not exceed the undiscounted future cash flows from production of proved reserves. Undiscounted future cash flows are calculated based on management's best estimate of forward indexed prices applied to estimated future production of proved reserves, less estimated future operating costs, royalties net of Alberta Royalty Tax Credits, capital and income taxes, future development costs and abandonment costs. The cost of undeveloped properties, less any impairment, is added to the estimated future cash flow.

When the carrying amount of a cost centre is not recoverable, the second stage of the process will determine the impairment whereby the cost centre would be written down to its fair value. The second stage requires comparing the capitalized costs to the discounted future cash flows from the proved plus probable reserves plus the cost of unproved properties, less any impairment. The fair value is estimated using accepted present value techniques, which incorporate risks and other uncertainties when determining expected cash flows. Any impairment is included in depletion and depreciation.

Furniture and equipment

Furniture and equipment are recorded at cost and are depreciated on a declining basis at twenty percent.

Joint ventures

A substantial portion of the Corporation's oil and gas activities are conducted jointly with others. The financial statements reflect only the Corporation's proportionate interest in such activities.

Asset retirement obligations

The Corporation recognizes the fair value of any asset retirement obligations as a liability in the period in which it incurs a legal obligation associated with the retirement of tangible long-lived assets that result from the acquisition, construction, development, and normal use of the assets. The Corporation uses a credit-adjusted risk free discount rate to estimate this fair value. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset and depleted and depreciated using the method described above under "Depletion and depreciation". Subsequent to the initial measurement of the asset retirement obligation, the obligation is adjusted at the end of each subsequent period to reflect the passage of time and changes in the timing and amount of estimated future cash flows underlying the obligation. Actual costs incurred upon settlement of the retirement obligation are charged against the obligation to the extent of the liability recorded.

Income Taxes

The Corporation uses the liability method of accounting for future income taxes. Under this method, future income taxes are determined based on the differences between the tax basis of assets or liabilities and their carrying amounts in the financial statements. Future income taxes are computed using the substantively enacted corporate income tax rates in effect each year. The effect on future income tax assets and liabilities of a change in the tax rates is recognized in net income in the period in which the change is substantively enacted. Future income tax assets are limited to the amount that is more likely than not to be realized.

Flow-through shares

A portion of the Corporation's exploration activities is financed through proceeds received from the issue of flow-through shares whereby the tax attributes of the exploration expenditures are renounced to the share subscribers. To recognize the tax benefits renounced by the Corporation, the carrying value of the shares issued is reduced by the tax effect of the tax deductions received by the subscribers. The tax effect of the renouncement is recorded when the exploration expenditures are renounced to the investors.

Per share amounts

The treasury stock method of calculating per share amounts is used whereby any proceeds from the exercise of in-the-money stock options, performance warrants or other dilutive instruments are assumed to be used to purchase common shares at the average market price during the period.

Net income per share has been calculated based on the weighted average number of common shares outstanding during the period of 25,901,870 basic and diluted. All stock options and performance warrants were anti-dilutive at December 31, 2005.

Stock-based compensation

The Corporation issues stock options to directors, officers, employees and consultants. Compensation costs attributable to the stock options granted are accounted for in accordance with the fair value method of accounting at the date of the grants and expensed or capitalized over the vesting period with an offsetting amount recorded to contributed surplus. The estimate of the fair value is determined using the Black-Scholes options pricing model. When stock options are exercised, the cash proceeds together with the amount previously recorded as contributed surplus are recorded as share capital. The Corporation does not incorporate an estimated forfeiture rate for stock options that will not vest, but accounts for forfeitures as they occur.

Warrants

The Corporation issued 6,900,000 performance warrants to directors, officers and employees upon the closing of its initial private financing on May 5, 2005. The estimate of the fair value of the warrants of $2,346,000 has been determined using an options pricing model and has been recorded in shareholders' equity with an offset to the value of the common shares issued at that time. When the warrants are exercised, the cash proceeds together with the amount previously recorded as warrants will be recorded as share capital.

Revenue recognition

Revenue from the sale of petroleum and natural gas is recognized based on volumes delivered to customers at contractual delivery points and rates. The costs associated with the delivery, including operating and maintenance costs, transportation and production based royalty expenses are recognized in the same period in which the related revenue is earned and recorded.

Measurement uncertainty

The amounts recorded for depletion and depreciation of oil and natural gas properties and equipment, the provision for future site restoration and abandonment costs and stock-based compensation are based on estimates. The ceiling test is based on estimates of proved reserves, production rates, oil and gas prices, future costs and other relevant assumptions. By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future periods could be significant.

3. PROPERTY AND EQUIPMENT

	December 31, 2005		
	Cost	Accumulated Depletion and Depreciation	Net
Petroleum and natural gas properties	$18,186,650	$ 99,457	$18,087,193
Furniture and equipment	61,103	8,147	52,956
	$18,247,753	$ 107,604	$18,140,149

At December 31, 2005, the cost of petroleum and natural gas properties includes $4,765,171 relating to unproven properties that have been excluded from the depletion calculation. Future development costs of $3,559,000 required to complete wells for which proved reserves have been assigned were added to the Corporation's net book value in the depletion calculation. The Corporation capitalizes certain general and administrative expenditures and stock-based compensation directly related to exploration. During the period

ended December 31, 2005, $597,251 and $1,779,378, respectively, of such costs were charged to petroleum and natural gas properties.

For purposes of the full cost impairment test, the Corporation has used benchmark prices ranging from $7.20 to $10.60 per mcf of natural gas and $42.43 to $50.72 per barrel for natural gas liquids in each of the first five years of the calculation. After the year 2016, an inflation factor of two percent per year has been included in the price forecasts.

4. **ASSET RETIREMENT OBLIGATION**

The following table summarizes changes in the asset retirement obligation as follows:

	From incorporation to December 31, 2005
Asset retirement obligation, beginning of period	$ -
Liabilities incurred	101,411
Accretion expense	135
Asset retirement obligation, end of period	$ 101,546

The total future asset retirement obligations are estimated by management based on the expected costs to abandon and restore the well sites and the estimated timing of the costs to be incurred in future periods. The Corporation has estimated undiscounted cash flows required to settle the obligations of $320,844, which will be incurred between 2014 and 2045. The majority of the costs will be incurred between 2015 and 2033. An inflation factor of 2.0 percent has been applied to the estimated asset retirement cost. A credit-adjusted risk-free rate of 8.0 percent was used to calculate the fair value of the asset retirement obligations.

5. **SHARE CAPITAL**

Authorized:

Unlimited number of voting common shares
Unlimited number of preferred shares, issuable in series

Issued:

	Amount	# of Shares
Common shares		
Balance, beginning of period	-	-
Private placements of shares	$34,500,001	34,500,001
Issuance costs	(1,940,062)	-
Tax benefits on issuance costs	652,249	-
Balance, December 31, 2005	$33,212,188	34,500,001

Private placements

In February 2005 the Corporation issued 1 common share for total proceeds of $1.00 upon incorporation.

On May 5, 2005, pursuant to a private placement, 33,045,000 common shares and 1,455,000 flow-through common shares were sold at an issue price of $1.00 per share for gross proceeds of $34,500,000. Total costs related to the placement were $1,940,062. All of the flow-through common shares were issued to management and directors of the Corporation.

The Corporation's total commitment for flow-through expenditures of $1,455,000 had been met and the related income tax deductions were renounced to the flow-through shareholders as of December 31, 2005.

Stock Options

The Corporation has a stock option plan whereby the number of shares that may be reserved for issuance pursuant to stock options shall not exceed ten percent of the outstanding common shares from time to time. No eligible optionee may hold stock options to purchase more than five percent of the outstanding common shares of the Corporation. Option prices, which must be no less than $1.00 per share, and expiry dates are set by the Board of Directors upon issuance. One third of the options vest when granted, one third vest on the first anniversary of the grants and one third vest on the second anniversary of the grants.

A summary of the outstanding stock options issued from the date of incorporation until December 31, 2005 follows:

Fixed Options	Shares	Weighted-Average Exercise Price
Outstanding, beginning of period	-	
Granted	450,000	1.00
Outstanding, December 31, 2005	450,000	1.00
Exercisable, December 31, 2005	150,000	

Options Outstanding and Exercisable as of December 31, 2005

Exercise Prices	Number Outstanding	Weighted-Average Remaining Life	Weighted-Average Exercise Price	Number Exercisable
$1.00	450,000	4.60 years	$1.00	150,000

Performance Warrants

Pursuant to the initial placement of shares on May 5, 2005, the Corporation issued performance warrants to management, directors and employees to purchase up to 6,900,000 common shares. Each performance warrant entitles the holder to acquire one common share at a price of $1.00 until May 5, 2010 subject to certain vesting provisions as follows:

(1) 20% of the warrants shall vest when the net asset value per share (as defined) of the Corporation exceeds an annualized 15% internal rate of return and $1.50; or

(2) 25% of the warrants shall vest if the Corporation is traded on a qualified market and the sixty day market price exceeds $1.50 but no other vesting event has previously occurred; or

(3) 50% of the warrants shall vest when the net asset value per share of the Corporation exceeds an annualized 20% internal rate of return and $1.50 or if the Corporation is traded on a qualified market and the sixty day market price exceeds $1.75; or

(4) 100% of the warrants shall vest when the net asset value per share of the Corporation exceeds an annualized 25% internal rate of return and $1.50 or if the Corporation is traded on a qualified market and the sixty day market price exceeds $2.00.

As of December 31, 2005, all of the performance warrants became fully vested pursuant to Clause (4) above. None of the performance warrants were exercised during 2005.

Stock-based compensation

In calculating the fair value of the options granted in 2005, the assumptions made include, a weighted average risk-free interest rate of 3.46%, no dividend yield, a weighted average expected life of options of 3 years and a vesting period of two years. The fair value of the 2005 common share options was estimated to be $153,000 of which $68,000 has been recognized in 2005; $13,222 expensed as stock-based compensation and $54,778 capitalized to petroleum and natural gas properties.

In calculating the fair value of the performance warrants granted in 2005, the assumptions made include, a weighted average risk-free interest rate of 3.64%, no dividend yield, a weighted average expected life of the warrants of 3 years and an expected vesting period of eight months. The fair value of the 2005 performance warrants was estimated to be $2,346,000, of which $751,000 is included as a stock-based compensation expense and $1,595,000 has been capitalized to petroleum and natural gas properties in 2005.

In calculating the fair value of the benefit related to the flow-through shares issued to management in May 2005, an assumed premium of 20% over the issue price of the associated common shares was utilized based upon historical premiums of flow-through share issues of similar private companies. The fair value of the benefit related to the flow through share issue was estimated to be $291,000, of which $161,400 is included as a stock based compensation expense and $129,600 has been capitalized to petroleum and natural gas properties. The financial statements as previously presented have been restated for these amounts. Previously no amounts were recorded as compensation expense or capitalized to petroleum and natural gas properties related to stock based compensation from these flow-through shares.

Contributed surplus

Balance, beginning of period	$ -
Stock based compensation for the period	2,705,000
Balance, December 31, 2005	$ 2,705,000

6. **FUTURE INCOME TAXES**

Future income taxes differ from the amount which would be obtained by applying statutory income tax rates to income before taxes as follows:

Tax rate	37.62%
Loss before taxes	$ 288,255
Expected income tax recovery	$ (108,422)
Stock based compensation	348,219
Crown royalties and charges	38,060
Resource allowance	27,878
Change in rates	(31,605)
ARTC	(12,054)
Other	3,582
Future income tax expense	$ 265,638

The components of the Corporation's future income tax asset at December 31, 2005 are as follows:

Petroleum and natural gas properties	$ 522,317
Share issue costs	(521,799)
Non-capital losses	(351,339)
Asset retirement obligation	(34,140)
Other	(1,650)
Future income tax asset	$ 386,611

As at December 31, 2005, the Corporation had $14,895,000 in tax pools and $1,045,000 in non-capital loss carryforwards available to reduce future taxable income.

7. **RELATED PARTY TRANSACTIONS**

Related party transactions are measured at the fair value based upon the service provided.

A company controlled by one of the directors of the Corporation provided engineering consulting services during the year in the amount of $23,355.

The Corporation uses the services of a law firm in which one of its partners became a Director in October, 2005. During the period from the date of incorporation to December 31, 2005, the Corporation incurred $106,742 on services provided by the firm. The services related to financing and other general corporate matters.

8. FINANCIAL INSTRUMENTS

Fair Value of Financial Assets and Liabilities

Financial instruments recognized in the balance sheet consist of cash and cash equivalents, accounts receivable, deposits and accounts payable and accrued liabilities. The fair values of the financial instruments approximate their carrying amounts due to the short-term maturity of these instruments.

Risk Management

The Corporation is exposed to credit-related losses in the event of default by counter-parties to financial instruments. The Corporation does not expect any counter-parties to fail to meet their obligations because the Corporation limits its transactions to counter-parties of high credit quality.

The nature of the Corporation's operations results in exposure to fluctuations in commodity prices and interest rates. As of December 31, 2005 no controls to manage exposure to these risks were in place.

Credit Risk

Approximately fifty-four percent of accounts receivable at December, 2005 is represented by the Corporation's joint venture relationship with a Canada based energy company. Management believes that there is no unusual exposure associated with the collection of this receivable due to the size and reputation of the company and to the continuing joint venture relationship. In addition, the company has no history of credit loss.

9. COMMITMENTS

The Corporation leases office premises under an agreement, which expires in June, 2010. The minimum lease payments required under the lease are $157,300 for each of 2006; 2007; 2008 and 2009 and $78,600 for 2010.

On November 1, 2005, the Corporation entered into an agreement with an industry partner whereby the Corporation committed to drill five wells to earn an interest in ten sections (3840 net acres) of land. Should the Corporation drill and complete or abandon less than five wells prior to July 31, 2006, the Corporation must pay the industry partner a penalty of $1,500,000 for each well not drilled and in addition will not earn an interest in any of the lands.

On January 16, 2006, the Corporation entered into an agreement with a certain drilling contractor whereby the Corporation committed to the use of a drilling rig for a minimum of 230 days prior to December 31, 2006 at rates that are consistent with current standard industry rates.

10. SUBSEQUENT EVENT

On March 15, 2006, the Board of Directors of the Corporation approved the immediate payment of bonuses to its employees totalling $137,000. An additional $213,000 has been approved for payment later in 2006 pending the achievement of certain performance hurdles. Also on March 15, 2006, the Board approved the issuance of an additional 2,030,000 stock options to certain employees, consultants and directors to acquire common shares of the Corporation at a price of $1.75 per share.